(19)

No. 91-913

In The
Supreme Court Of The United States

OCTOBER TERM, 1991

JOHN R. PATTERSON, TRUSTEE,

Petitioner,

v.

JOSEPH B. SHUMATE, JR.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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STATEMENT OF THE CASE

Shumate's statement of the case (Br. p. 1) presents some incomplete representations of fact not supported by the record. There is no evidence in the record which in any way establishes the CFC Plan benefits are necessary for Shumate's livelihood. There is likewise no evidence establishing Shumate's employment status at any point since he filed for bankruptcy. While Shumate did proceed _in forma pauperis_ in this case, it was done with the Trustee's acquiescence to facilitate the disposition of this matter without endless litigation over his _in forma pauperis_ status.

REPLY ARGUMENT

I. _The plain meaning of Bankruptcy Code § 522(d)(10)(E)(iii) is rendered superfluous if_

"applicable nonbankruptcy law" under § 541(c)(2) creates an exclusion of ERISA pension benefits from the bankruptcy estate.

The Trustee, as well as _amicus_, Tatge, stand on the proposition that the plain language of § 522(d)(10)(E)(iii) establishes that a debtor's rights in a private employer's ERISA qualified § 401(a) pension plan, such as the CFC Plan, of necessity must be included in the bankruptcy estate under § 541. Otherwise, § 522(d)(10)(E)(iii) will be deprived of its substantive meaning.

If the plain meaning of § 522 is to be followed to give effect to the specific reference by Congress in § 522(d) to exempt pension, stock bonus and profit sharing ERISA benefits, it logically follows those same benefits could not be excluded from

the bankruptcy estate under § 541(c)(2).

It seems evident from the statutory language of § 522(d)(10)(E)(iii) that the Trustee is correct on this point unless one of two circumstances exists:

1. §522(d)(10)(E) (iii) is limited to the small minority of IRC § 401(a) plans covering churches and government plans (which are not required by ERISA to have an antialienation clause); or,

2. § 522(d)(10)(E)(iii) is limited in application only to current distributions from ERISA plans.

The Bankruptcy Code's legislative history (Tr. Br. p. 21, 25) establishes that all the debtor's property comes into the estate with exemptions then taking effect under §522. The Report of the Commission on the Bankruptcy Laws of the United States, (Tr. Br. p. 28), discusses the precursor of §522(d)(10)(E), §4-503.

Note 8 to § 4-503 establishes that the drafters of the Bankruptcy Code intended rights under tax qualified pension plans of private companies to come into the estate, and thereafter be exempted subject to a reasonable support limitation (Tatge Br. p. 10), (U.S. Br. p. 22).

Amicus, the United States, argues (Br. 17, 18) there were a small number a pre-Code cases treating federal trust property as excluded from the bankruptcy estate. The Government's argument ignores the statutory language of §522(d)(10)(E)(iii) of present law, which requires, on its face, that a debtor's pension rights under a plan which is tax qualified under §401(a) first comes into the estate. Second, the United States ignores the fact there is a much broader scope of "property of the estate" under the Bankruptcy Code, as opposed to under prior law. Indeed, the

legislative history of §541(c)(2) states that it "continues over the exclusion from property of the estate of the debtor's interest in a spendthrift trust to the extent that the trust is protected from creditor's under applicable State law" (emphasis added). H.R. Rep. No. 595, 95th Cong. 1st Ses. 369, 176 (1977). The drafters of the Bankruptcy Code may well have intended thereby to signal that restrictions on transfer under "federal law" itself were no longer a reason to exclude property from the estate (if indeed they ever were), consistent with the drafter's intent to exempt under §522(d)(10)(E) a debtor's rights under a private employer's pension trust qualified under §401(a), at least where "federal" exemptions were chosen. Finally, expanding the scope of § 4-601 in § 541(c)(2) as enacted to wholly exclude a debtor's rights

under a state law spendthrift trust, such as a testamentary trust, in no way establishes that § 401(a) pension trusts, exempted under § 522(d)(10)(E), are covered by § 541(c)(2). The Government's analysis is merely a restatement of its own position, contrary to the statutory language of § 522(d)(10)(E)(iii).

The other circumstance by which the Trustee's argument might fail rests on the position of the Third Circuit in Vellis v. Kardanis, 949 F. 2d, 78, 80 (3rd Cir. 1991), which holds that § 522(d)(10)(E) is harmonized with § 541(c)(2) by treating the exemptions under § 522 as applying only to an immediate and present right to receive benefits. Even amicus, the United States, (Br. p. 23 N. 16) does not agree with this position. Moreover, none of the cases cited by the Trustee or Tatge are distinguished.

The argument that § 522(d)(10)(E) will allow the Trustee to reach distributions during the pendency of the bankruptcy effectively represents a complete exclusion as few cases, particularly with controlled plans, would have distributions.

The straight forward reading required by the cannons of statutory construction, which both Shumate and amicus, the United States seek, requires, if anything, that § 522(d)(10)(E) be given its "plain meaning" with respect to § 401(a) pension, stock bonus and profit sharing plans, rather than any "plain meaning" to be ascribed to "applicable nonbankruptcy law" in § 541(c)(2), which is ambiguous and subject to varying interpretations (Tr. Br. p. 33-39).

II. This Court's decision in Guidry does not bar the application of 29 U.S.C. § 1144(d), the ERISA savings clause, in bankruptcy matters.

Shumate (Br. 19,20) and amicus, the United States (Br. P. 12,13), cite this Court's decision in Guidry v. Sheet Metal Workers Pension Fund, 110 S.Ct. 680 (1990) as establishing an over-riding policy to exclude ERISA pension benefits from the bankruptcy estate despite contradictions in the Bankruptcy Code. These arguments do not adequately address the impact of ERISA's savings statute, 29 U.S.C. § 1144(d), where there is a conflict between ERISA and the Bankruptcy Code.

The creditor in Guidry argued 29 U.S.C. § 1144(d) applied to thwart the antialienation protection of 29 U.S.C. § 1056(d)(1) by virtue of a broad grant of a cause of action under the Labor Management Relations Act (LMRA). This Court rejected that argument for reasons significantly

different from the case at bar.

First, the LMRA has its own savings clause, 29 U.S.C. § 523(a). This Court viewed the existence of that statute to effectively trump the use of the ERISA savings clause to give any portion of the LMRA priority over ERISA. 110 S. Ct. 680, 687 (Note 17). No such savings clause, parallel to that of the LMRA, applies to the Bankruptcy Code.

Secondly, the LMRA's purported conflict with ERISA was through the broad grant of a cause of action which made no reference to ERISA (Tr. Br. p. 45). This is far different from the specific Bankruptcy Code provisions at issue here. Section 541 creates an all inclusive estate, even of property which may subsequently be exempt. (Tr. Br. p. 27). Unlike the LMRA, Bankruptcy Code § 522 specifically refers to qualified §401(a)

plans subject to ERISA.

There is no question that Guidry controls the application of ERISA in a nonbankruptcy setting. However, ERISA's savings clause does not act as a bar to bankruptcy treatment of ERISA benefits in a manner different from that of nonbankruptcy treatment. On the contrary, ERISA's savings clause was included by Congress to insure that another federal statute in conflict was not subjugated to the ERISA directive. Had Congress desired an exception to the ERISA savings clause in 29 U.S.C. § 1144(d) for bankruptcy purposes, it would have included such either in Title 29 or Title 11 of the United States Code (as in the LMRA) but has not done so.

III. The spectre of involuntary bankruptcy filings or tax disqualification of ERISA plans

is speculative and unsupported.

Shumate (Br. P. 24, 25) and amicus, the United States (Br. p. 11, 26), argue a flood of involuntary bankruptcies and tax disqualifications of ERISA plans would ensue if the Trustee's position is adopted. These arguments are not supported upon close examination and run contrary to the expressed congressional intent for treatment of ERISA benefits in bankruptcy.

No party cites any case where a debtor was placed in involuntary bankruptcy in order to get at his ERISA plan benefit. Despite the long standing run of this type litigation, as well as the multitude of such cases, it seems difficult to see this prospect as a cogent threat since none has occurred.

Similarly, the argument of a federal income tax armageddon is not supported by any reported case on point. Both Shumate

(Br. 25) and amicus, the United States (Br. p. 11), offer the opinion of the Internal Revenue Service, through a few private letter rulings, that tax disqualification of an ERISA plan might occur in the event the plan trustee obeyed a valid federal court order to turn over assets of a pension plan to a bankruptcy trustee. This argument is difficult to justify since the Government represents it has the discretion not to pursue disqualification in any event (U.S. Br. p. 11. N.5).

Once again, no party cites any case where such an action has occurred or even been proposed by the Internal Revenue Service despite the long history and number of such cases. This could be, in part, because the Internal Revenue Code specifically prohibits using such private letter rulings as any authority. 26 U.S.C. § 6110(j)(3). By contrast, as noted by

amicus, Tatge (Br. p. 27), there are a number of cases where the debtor has raised the possibility of disqualification, but not the Internal Revenue Service. The Courts studying that question have found no disqualification of the plan.

These policy arguments are overblown, in any event, when taken in the context of the extremely limited number of cases (and for that matter pension plans) to which a ruling for the Trustee in this case would apply.

Only a minute minority of plan participants who become debtors in bankruptcy would possess the requisite dominion and control over the pension plan which would bring the plan benefit into the estate. This circle is even more tightly drawn under the facts of this case as it deals with plan benefits from a terminating plan in pay status. Both of these are

significantly limiting factors that significantly ameliorate any of the policy concerns raised by Shumate and the various amici.

As discussed below, the invasive impact on a continuing pension plan, where the debtor is not presently entitled to the plan benefit, is de minimus. The Trustee could not accede to a benefit not available to the debtor. In Re Schauer, 835 F.2d 1222 (8th Cir. 1987).

IV. Under the Midlantic National Bank rule, the pre-Code practice which includes distributable benefits from a terminated plan as part of the bankruptcy estate is carried over under the Code.

The Trustee (Br. p. 39-42) discussed the rule of bankruptcy interpretation established by Midlantic National Bank v.

New Jersey, 474 U.S. 494 (1986) and recently affirmed by this Court in Dewsnup v. Timm, No. 90-741, 60 U.S.L.W. 4111, 4113 (decided January 15, 1992).

> This Court has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in a legislative history.

No party contests the broad point that the Bankruptcy Code continues over the exclusion of spendthrift (U.S. Br. p. 17) trusts from the estate and that practice is continued under the Midlantic rule. As Dewsnup indicates, pre-Code practice, unless specifically changed by the Bankruptcy Code, or its legislative history, continues to be the law.

Amicus, Wal-Mart Stores, Inc., (Br. p. 20-24) and amicus ERISA Industry Committee

(Br. p. 21), discuss that it was pre-Code practice to include in the bankruptcy estate pension benefits in pay status from a terminated plan, which is the case with Shumate's benefit in the CFC plan.

Amicus, the United States, (Br. 17) implies a pre-Code practice of exclusion from the estate for certain trust assets, but not as to benefits from a terminated plan ready for payment. In fact, the cases cited by the government, support the Trustee's position. Danning v. Lederer, 232 F.2d 610, 614 (7th Cir. 1956), found the bankruptcy trustee was not prevented from obtaining the debtor's beneficial interest in a trust unless state law governing the trust stopped him. Similarly, Jones v. Harrison, 7 F.2d 461 (8th Cir. 1925) was based on what state law rights the bankruptcy trustee acquired and those determined what was in the estate.

Neither case dealt with pre-ERISA protection and neither trust was terminated with the beneficiaries awaiting distribution.

Amicus, ERISA Industry Committee (Br. p. 21), and amicus, Wal-Mart Stores, Inc., (Br. p. 20) concede that an ERISA benefit distributable to the participant at the time of bankruptcy from a terminated plan was included in the Bankruptcy estate under pre-Code law. Indeed, the ERISA Industry Committee admits they can find no opinion which excluded such a presently distributable interest from the bankrupt's estate under Section 70 of the Bankruptcy Act. No other party cites a contrary case.

While there are cases excluding benefits in a federal plan, Tennessee Valley Authority vs. Kincer, 142 F. 2d 833 (6th Cir. 1944), or a continuing plan to which the debtor had no access, Turpin v.

Wente, 644 F.2d 472 (5th Cir. 1981) there appears to be clear pre-Code bankruptcy law including ERISA covered benefits in pay status in the bankruptcy estate. Dunlavey vs. Newman, 2 Br. 500 (Bankr. D. Ariz. 1980). Short v. Grand, 507 F. 2d 425 (8th Cir. 1974). Judson v. Witlin, 640 F. 2d 661 (5th Cir. 1981). These cases follow the bankruptcy maxum that the Bankruptcy Trustee acquires no greater rights than the debtor enjoyed. It is to this right of Shumate that the Trustee argues he has succeeded (Tr. Br. p. 32).

Newman, Grand and Witlin, following the direction of this Court's decision in Kokoszka v. Belford, 417 U.S. 642 (1974) held, despite antialienation provisions, that the plan interest of each debtor was an included bankruptcy estate asset. Each debtor had a present right to receive the benefit included in his estate.

This is the case with Shumate's CFC plan benefit. The CFC plan's termination, July 19, 1984, (J.A. 70, 71, 350) predates Shumate's entry into liquidation under Chapter 7. At the time Shumate's bankruptcy estate became eligible for liquidation, his right to the distribution from the terminated CFC Plan was fixed and simply awaiting distribution. He had a present right to all of the benefit which, as a matter of course, was reduced to cash.

As Witlin and related cases indicate, such a benefit right from a terminated plan in pay status at the time of bankruptcy was included in the bankruptcy estate under pre-Code law. Following the rule of Dewsnup and Midlantic National Bank, since there is no Bankruptcy Code provision or legislative history negating this practice, it is valid bankruptcy law today to include the CFC plan benefit in the bankruptcy

estate.

CONCLUSION

For the reasons cited by the Trustee in his brief and reply brief, the Trustee respectfully asks that the decision of the Court of Appeals be reversed and judgment entered in favor of the Trustee that he is entitled to Shumate's CFC Plan benefits as a nonexempt asset of the bankruptcy estate.

Respectfully submitted,

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